CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO. 132 OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 21ST AND 22ND SEPTEMBER, 2020

The Monetary Policy Committee (MPC) met on Monday, 21st and Tuesday, 22nd September, 2020, in the light of lingering uncertainties associated with the COVID-19 pandemic and downturn in crude oil prices. These uncertainties which centered primarily on when the pandemic will be fully subdued and the oil market return to normalcy, have resulted in persistent weak aggregate demand, disruptions in global supply chains, mixed price development, volatile and downward trending oil prices, as well as rising unemployment.

The Committee reviewed these developments and assessed their impact on the domestic economy in the first three quarters of 2020 and noted the outlook for the rest of the year.

Ten (10) members of the Committee were in attendance.

Global Economic Developments

The Committee observed the moderate improvement in global output performance with widespread recession in the second quarter of 2020. This followed the sharp decline in output growth in the Advanced Economies and some Emerging Markets and Developing Economies (EMDEs), as well as the risk of further deterioration in global output growth, associated with the lingering shocks from the COVID-19 pandemic. Global exports and international travels, however, showed signs of gradual, but sluggish recovery, as countries relax restrictions to allow for resumption of economic activities.

The International Monetary Fund (IMF), therefore, remained cautious of its global growth forecast for 2020, which was hinged on the near-term

containment of the pandemic. The likelihood of a second-round spike in the rate of infection is, however, undermining hopes of an early return to normalcy. Oil exporting countries are also likely to face further revenue shortfalls as a result of the decision by OPEC+ to reduce its production ceiling from 9.6 million barrels per day to 7.7 million barrels per day. Due to these headwinds, we suspect that the global economy may suffer a deeper contraction in 2020 than the 4.9 per cent projected by the IMF. This may also dampen the projected recovery in 2021.

The MPC observed the huge injection of monetary and fiscal stimulus into the global economy, noting its medium-term inflationary potential. In major advanced economies, inflation mostly remained below their 2.0 per cent long-run objectives, as the recovery of both global aggregate demand and supply remained stalled. Across the group of Emerging Market and Developing Economies, price development remained mixed, reflecting the diverse structure of these economies. The exchange rates of EMDEs continued to be under pressure as global capital flows were subdued, reflecting investor's preference for gold as a safe haven. With the unprecedented and coordinated injection of liquidity by central banks and fiscal authorities globally, the risk of another financial crisis post-COVID-19 can no longer be overlooked as this may likely crystalize into a double deep global recession when central banks across the globe move to normalize monetary policy.

In the global financial markets, conditions remain relatively tight reflecting continued uncertainties. Thus, while markets are showing moderate signs of recovery, financial conditions are yet to ease fully as investors remain cautious of the lingering risk of a second-round of lockdown.

Domestic Economic Developments

Available data from the National Bureau of Statistics (NBS) showed that real Gross Domestic Product (GDP) contracted by 6.10 per cent in the second quarter of 2020 compared with expansions of 1.87 and 2.12 per cent in the preceding quarter of 2020 and the corresponding period of 2019, respectively. The development ended, the three-year trend of low, but positive real GDP

growth recorded in Nigeria since the end of the 2016/17 recession. The contraction in Q2 2020 was largely driven by the poor performance of both the oil and non-oil sectors due to the lockdown to contain the spread of the pandemic in Q1 2020. The oil sector contracted by 6.63 per cent in Q2 2020 from -5.03 per cent in the previous quarter, while the non-oil sector contracted by 6.05 per cent in Q2 2020, compared with an expansion of 1.55 per cent in Q1 2020.

The MPC noted the continued weakness in economic activities as indicated by the Manufacturing and non-Manufacturing Purchasing Manager's Indices (PMIs), which remained below the 50-index point benchmark. In August 2020, the Manufacturing and non-Manufacturing PMIs were 48.5 and 44.3 index points, respectively, compared with 42.4 and 43.3 index points in July 2020. This was attributed to slower growth in production, business activities, new orders, supply delivery time, employment level, new export orders and raw materials and input prices. Similarly, the employment level index component of the Manufacturing and non-Manufacturing PMIs in August 2020 was 44.6 and 44.3 index points, respectively, compared with 40.0 and 41.1 index points in July 2020. The Committee was, however, optimistic that with the easing of the lockdown and gradual resumption of economic activities, the PMIs will improve in the short-to medium term.

The Committee expressed deep concern on the continued uptick in inflation for the twelfth consecutive month as headline inflation (year-on-year) rose to 13.22 per cent in August 2020 from 12.82 per cent in July 2020. The increase in headline inflation was largely driven by the persistent increase in the food component, which rose to 16.00 per cent in August 2020 from 15.48 per cent in July 2020. The core component also rose to 10.52 per cent in August from 10.10 per cent in July 2020. These upticks were driven primarily by legacy structural factors such as the inadequate state of critical infrastructure and broad-based security challenges across the country, which dampened production activities. Other factors include the disruptions to supply chains following restriction to movements to curb the spread of the pandemic; adverse weather conditions,

which resulted in flooding of farmlands; as well as the inflation pass-through to domestic prices following the depreciation in the exchange rate. The recent increase in energy cost is also expected to further impact the domestic price level in the short-term.

The Committee, therefore, stressed the urgent need for a combination of broad-based monetary and fiscal policy measures to curb the rise in inflation and contraction in output growth. This will involve targeted investment by the fiscal authorities to resuscitate critical infrastructure to improve the ease of doing business across the country. In addition, the MPC believes the fiscal authorities can build on earlier efforts and articulate a clear strategy to attract private sector investment. The Bank will, however, continue to take relevant steps to ensure that the detrimental risk of inflation to the economy is contained.

The Committee noted the various interventions by the CBN to reflate the economy, improve aggregate supply and drive down inflation. Recent interventions were largely in the areas of Manufacturing, Agriculture, Electricity & Gas, Solar Power and housing constructions among others. It expressed optimism that these initiatives will significantly ease the adverse impact of the COVID-19 pandemic and set the economy on a path of recovery. So far, total disbursements from the Bank's interventions in the wake of the COVID-19 pandemic amounted to N3.5 trillion including: Real Sector Funds, (N216.87 billion); COVID-19 Targeted Credit Facility (TCF), (N73.69 billion); AGSMEIS, (N54.66 billion); Pharmaceutical and Health Care Support Fund, (N44.47 billion); and Creative Industry Financing Initiative (N2.93 billion). Under the Real Sector Funds, a total of 87 projects that included 53 Manufacturing, 21 Agriculture and 13 Services projects were funded. In the Health Care sector, 41 projects which included 16 pharmaceuticals and 25 hospital and health care services were funded. Under the Targeted Credit Facility, 120,074 applicants have received financial support for investment capital. The Agri-Business/Small and Medium Enterprise Investment Scheme (AGSMEIS) intervention has been extended to a total of 14,638 applicants, while 250 SME businesses, predominantly the youths,

have benefited from the Creative Industry Financing Initiative. In addition to these initiatives, the CBN is set to contribute over N1.8 trillion of the total sum of N2.30 trillion needed for the Federal Government's 1-year Economic Sustainability Plan (ESP), through its various financing interventions using the channels of Participating Financial Institutions (PFIs). The MPC is, thus, using this medium to appeal to our important economic stakeholders to take advantage of these intervention initiatives to help support a quick rebound in growth.

The Bank's policy on Loan to Deposit ratio also resulted in a significant growth in credit to various sectors from N15.57 trillion to N19.33 trillion between end-May 2019 and end-August 2020, an increase of N3.77 trillion. This growth in credit was mainly to manufacturing (N866.27 billion), consumer credit (N527.65 billion), oil & gas (N477.65 billion), agriculture (N287.11 billion) and construction (N270.97 billion).

On Monetary Aggregates, broad money supply (M3) rose to 6.93 per cent (year-to-date) in August 2020 from 5.23 per cent in July 2020, reflecting the increase in both Net Foreign Assets and Net Domestic Assets. Similarly, aggregate domestic credit (net) grew by 6.94 per cent in August 2020 compared with 9.43 per cent in July 2020.

Money market rates remained relatively stable in the review period with some mild volatility, reflecting the prevailing liquidity conditions in the banking system. The monthly weighted average Inter-bank call rate increased to 7.38 per cent in August 2020 from 6.25 per cent July 2020, while the Open Buy Back (OBB) rate decreased to 8.39 per cent in August 2020 from 10.12 per cent in July 2020.

The MPC noted the moderate improvement in the equities market in the review period, as the All-Share Index (ASI) increased by 5.78 per cent from 24,174.75 on July 21, 2020 to 25,572.57 on September 18, 2020. On a year-to-date basis, however, the ASI decreased by 4.73 per cent compared with 26,842.07 as at December 31, 2019. Market Capitalisation (MC) also increased by 5.98 per cent from N12.61 trillion to N13.36 trillion over the same period. As a lead indicator,

therefore, this improvement in market indices signposts the commencement of a broad-based economic recovery.

The Committee also noted the decrease in the NPLs ratio to 6.1 per cent at end-August 2020 compared with 9.4 per cent in the corresponding period of 2019 due largely to recoveries, write offs and disposals.

The Committee expressed confidence in the overall stability of the banking system as reflected in the positive performance of the financial soundness indicators (FSIs), despite the persistence of the COVID-19 pandemic. It however, called on the Bank to sustain its regulatory oversight on the industry in the light of the continued fragility of macroeconomic indicators and the impact of the COVID-19 pandemic and the growing risk of cyber-attacks on business and economic activities.

On the external sector, the Committee noted the resumption of sales to Bureaux de Change (BDCs) in a bid to improve liquidity and ease demand pressure in the foreign exchange market. Consequently, the exchange rate appreciated at all windows. The MPC observed the recent improvement in external reserves and urged the Bank to maintain its prudent allocation of foreign exchange towards balancing supply and demand.

Outlook

The broad outlook for the global recovery remains uncertain, as the headwinds associated with the COVID-19 pandemic persist, especially due to new indications of a second spike in the rate of infections, continues to dampen prospects of a near term recovery.

With several economies contracting deeper than expected, the global economy may eventually contract beyond the -4.9 per cent earlier projected by the IMF, as the second-round spike in the infection rate has resulted in widespread localized lockdowns in some advanced and emerging market economies. In addition, the persisting volatility in global oil prices, which is likely

to continue beyond the end of 2020 as indicated by the deliveries in the oil futures market, signposts the likelihood of a disorderly global recovery.

The synchronized monetary policy accommodation by major central banks in both the Advanced and Emerging Market Economies, portends the likelihood of a medium-term debt crisis which may set the global economy into another downturn, if not properly managed.

On the domestic economy, staff forecast suggests that the economy may continue to grapple with the effects of the pandemic throughout the rest of the year. With persistent focus on activities meant to reverse the contraction, the MPC projects growth at positive levels in Q4 2020, or at the latest by Q1 2021, based on the anticipated positive results from the coordinated and sustained interventions by both the monetary and fiscal authorities. These interventions include, the coordinated response of the monetary and fiscal authorities to curtail the spread of the COVID-19 pandemic, reverse the downturn in the economy, improve sources of revenue in the non-oil sector and encourage the build-up of fiscal buffers.

The Committee's Considerations

The Committee's considerations focused on the major headwinds exerting downward pressure on output growth and upward pressure on domestic prices.

The key factors considered by the MPC as likely to exert upward pressure on domestic prices in the near term include: the prevalence of security challenges in the country; adverse weather conditions causing flooding in some farming regions; the increase in petroleum pump price; deregulation in electricity tariff; low crude oil price; and exchange rate adjustment.

The Committee noted that available evidence does not support the view that the rise in inflation was due to monetary factors. Rather, there is overwhelming evidence that the inflationary pressure reflects the prevalence of structural rigidities and supply shocks. Hence, the traditional tools of monetary policy may not be helpful in addressing current inflationary pressures. Instead, the useful

policies will be the supply-side measures implemented by the Bank. In the light of this, reducing MPR will signal to the Deposit Money Banks to lend more to stimulate growth, increase aggregate supply, which should dampen prices in the immediate term.

Although the MPC remains committed to its primary mandate of ensuring price stability, it however, noted the need to address the structural supply-side issues that are putting upward pressure on production cost and depressing economic growth. To this end, the Committee supports the various intervention programmes of the Bank towards stimulating production in the agricultural and manufacturing sectors to increase aggregate output and lower prices.

On Financial Markets, the Committee considered the impact of the dwindling capital inflows on yields in the equities, bonds and money markets. It, however, observed the improvement in the equities market from the second quarter of 2020, indicating prospects of medium-term economic recovery. Members also took cognizance of the prevailing low rates in the money market which are also below the lower band of the standing facilities corridor, as being a distortion to money market operations.

The Committee noted the increase in aggregate credit and encouraged further expansion in credit to employment-generating sectors to expedite growth recovery. It, however, urged the Bank to sustain its regulatory surveillance over the banking system to ensure that Non-Performing Loans (NPLs) remain low.

The Committee also noted the rising public debt profile and urged the fiscal authority to strengthen its debt management strategy, explore other sources of revenue, as well as enhance efficiency in public expenditure. It commended the combined effort of the Federal Government and the CBN in providing the required stimulus to contain the pandemic and ease its impact on the Nigerian economy.

The Dilemma of Monetary Policy

The MPC was at this meeting confronted by policy dilemma. Whereas MPC believes in the primacy of its price and monetary stability mandate, it nevertheless was confronted with what policy direction to focus on, given the contraction in output growth during the second quarter of 2020, which may lead to a recession, if the third quarter of 2020 output growth numbers further show a contraction. It is, therefore, of the view that, if a recession occurs in Q3 2020 the Committee would be confronted with proposing policy options in a period of stagflation. This is because, with the recent removal of subsidy on fuel price, the increase in energy prices, and the adjustment of the exchange rate, inflationary pressure will no doubt persist unless MPC consider options that will deal with the pressure aggressively.

The Committee was therefore of the view that, to abate the pressure, it had no choice but to pursue an expansionary monetary policy using development finance policy tools, targeted at raising output and aggregate supply to moderate the rate of inflation.

At present, fiscal policy is constrained and so cannot, on its own lift the economy out of contraction or recession given the paucity of funds arising from weak revenue base, current low crude oil prices, lack of fiscal buffers and high burden of debt services. Therefore, monetary policy must continue to provide massive support through its development finance activities to achieve growth in the Nigerian economy. This is the reason MPC will continue to play a dominant role in the achievement of the goals of the Economic Sustainability Program (ESP) through its interventionist role to navigate the country towards a direction that will boost output growth and moderate the level of inflation.

Similarly, given that the currency adjustment was a causal factor in determining the price of petroleum products and energy prices, the MPC believes that the CBN management must take bold actions to stabilize the exchange rate. Management was further enjoined by the MPC to continue to provide funding to sectors that will resolve the supply constraints in petrol pricing, energy pricing and food availability.

To support household consumption, the MPC enjoined management to aggressively channel its funding to targeted households, SMEs and consumer credit by further increasing its lending activities through its NIRSAL Microfinance Bank (NMFB). The Management was also directed to ensure that DMBs respond to the reduction in deposit rates by aggressively lowering cost of credit to borrowers.

As regards output growth, MPC noted that air and road transportation; entertainment & accommodation; food services; and education subsectors were adversely affected by the lockdown. It therefore suggested that more efforts be put in place to continue to provide relief and funding to these subsectors to catalyse growth and improve the output numbers.

Dealing with The Causal Factors of Inflation

In the view of the MPC, so far, evidence has not supported the rising inflation to monetary factors but rather, evidence suggests non-monetary factors (structural factors) as the overwhelming reasons accounting for the inflationary pressure.

Accordingly, the implication is that traditional monetary policy instruments are not helpful in addressing the type of inflationary pressure we are currently confronted with. What is useful is the kind of supply side measures currently being implemented. MPC also expects that a downward adjustment in MPR may be necessary to further put pressure on our deposit money banks to lower cost of credit in aid of growth.

The Committee's Decision

In the face of declining economic growth and rising inflation, the Committee faced a difficult set of policy choices, requiring trade-offs and sequencing.

Following the above considerations, the Committee reviewed the choices before it, bearing in mind its primary mandate of price stability and the need to support the recovery of output growth. Consequently, the Committee noted that the likely action aimed to addressing the rise in domestic prices would

have been to tighten the stance of policy, as this will not only moderate the upward pressure on prices, but will also attract fresh capital into the economy and improve the level of the external reserves. It however, noted that this decision may stifle the recovery of output growth and thus, drive the economy further into contraction.

On easing the stance of policy, the MPC was of the view that this action would provide cheaper credit to improve aggregate demand, stimulate production, reduce unemployment and support the recovery of output growth. The Committee, however, observed that with inflation trending upwards, easing of the policy stance may exacerbate the current inflationary pressure through an increase in money supply. In addition, the MPC noted the tendency of an asymmetric response to downward price adjustments by 'Other Depository Corporations', thus undermining the overall beneficial impact of a reduction to the cost of capital.

In the Committee's view, a hold position will allow the economy to adjust to the ongoing stimulus measures put in place by the monetary and fiscal authorities to curb the downturn and allow more time for the MPC to assess their impact on the economy.

After the consideration of the three policy options, Members were of the opinion that the option to loosen will complement the Bank's commitment to sustain the trajectory of the economic recovery and reduce the negative impact of COVID-19. In addition, the liquidity injections are expected to stimulate credit expansion to the critically impacted sectors of the economy and offer impetus for output growth and economic recovery.

In view of the foregoing, the Committee decided to reduce the MPR by 100 basis points to 11.5 per cent and adjust the asymmetric corridor to +100/-700 around the MPR.

Six (6) members voted to reduce the MPR by 100 basis points, one (1) member by 50.0 basis points and three (3) voted to hold. Nine (9) members voted to change the asymmetric corridor while one member voted to hold.

All members voted to hold the Cash Reserve Ratio (CRR) and Liquidity Ratio (LR).

In summary, the MPC voted to:

I. Reduce the MPR by 100 basis points from 12.5 to 11.5 per cent;

II. Adjust the asymmetric corridor from +200/-500 basis points to +100/-700 basis points around the MPR;

III. Retain the CRR at 27.5 per cent; and,

IV. Retain the Liquidity Ratio at 30 per cent.

Thank you.

Godwin I. Emefiele
Governor, Central Bank of Nigeria

22nd September, 2020